STATE OF CALIFORNIA ARNOLD SCHWARZENEGGER, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

June 16, 2006 Agenda ID # 5755

TO: PARTIES OF RECORD IN APPLICATION 05-10-026

This is the draft decision of Examiner Kevin P. Coughlan. It will appear on the Commission's June 29, 2006 agenda. The Commission may act then, or it may postpone action until later.

When the Commission acts on the draft decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Pursuant to Pub. Utilities Code Sec. 311(g)(2) and Rule 77.7(g), parties have stipulated to reduce the comment and review period. Comments on the draft decision must be filed and served not later than June 26, 2006 and no reply comments will be accepted.

Parties to the proceeding may file comments on the draft decision as provided in Article 19 of the Commission's Rules of Practice and Procedure. These rules are accessible on the Commission's Website at www.cpuc.ca.gov. In addition to service by mail, parties should serve comments in electronic form to those appearances and the state service list that provided an electronic mail address to the Commission, including Examiner Coughlan at kpc@cpuc.ca.gov. Comments should also be served electronically to Ramon Go (rhg@cpuc.ca.gov) and Joel Perlstein (jtp@cpuc.ca.gov).

/s/ KEVIN P. COUGHLAN
Kevin P. Coughlan
Examiner

KPC:rhg

TELCO/KPC/KOK/DLW/RHG

Decision **DRAFT DECISION OF EXAMINER COUGHLAN (Mailed 6/19/06)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of FORESTHILL TELEPHONE COMPANY U-1009-C, for an Order authorizing it to issue notes in an amount not exceeding $24,901,250, and to execute a related agreement and supplemental security instruments.	Application 05-10-026 (Filed October 21, 2005)

OPINION APPROVING LOAN AGREEMENT

1. Summary

This order authorizes Foresthill Telephone Company (Foresthill), with conditions, to enter into a loan agreement with The United States of America, acting through the Rural Utilities Service (RUS) and the Rural Telephone Bank (Bank) for the purpose of borrowing $24,901,250 to be used for system upgrades and to replace a higher cost interim financing arrangement; and in connection with the loan, to execute mortgages and security instruments, pursuant to Pub. Util. Code (Code) §§ 816, 817, 818 and 851.[1] This order also approves, on a prospective basis, the merger of Fortel, Inc. (Fortel) into Foresthill.

The Commission will separately open an investigation into whether the Code or Commission orders were violated when Foresthill apparently attempted to encumber its assets to secure the interim financing of an

[1] All statutory references are to the Public Utilities Code unless otherwise indicated.

acquisition debt without express authority of the Commission, and if so, whether penalties should be imposed. We will also address whether Foresthill has accounted for any payments made on this interim debt consistent with the below-the-line requirements imposed in this Decision.

2. Background

Foresthill is a California corporation, operating as a public utility telephone company, under the jurisdiction of the Commission. Foresthill is a local exchange telephone company, providing service to a portion of Placer County, California. Foresthill's property consists principally of telephone facilities, including central office equipment, aerial and buried cable, land, and buildings. Rose A. Hoeper (Hoeper) previously owned 100% of the issued and outstanding capital stock of Foresthill.

a. Transfer of Ownership

In Decision (D.) 05-05-045, dated May 26, 2005, in A.05-03-008, the Commission approved A.05-03-008, authorizing the sale and transfer of Hoeper's stock to Sebastian Enterprises, Inc. (SEI), for approximately $14.5 million, to be paid in cash, and recognized that SEI may take control of Foresthill through an intermediate subsidiary, if deemed necessary or convenient to secure financing or for related reasons. SEI, a California corporation, is a holding company located in Kerman, California. SEI is the parent company of Kerman Telephone Company, a rural incumbent local exchange carrier and Kertel Communications, Inc., a provider of communications equipment and various communications services.

In D.05-05-045 the Commission authorized SEI's purchase of the stock of Foresthill pursuant to § 854(a), which provides:

> No person or corporation, whether or not organized under the laws of the state, shall merge, acquire or control either directly

> or indirectly any public utility organized and doing business in this state without first securing authorization to do so from the commission. The commission may establish by order or rule the definitions of what constitute merger, acquisition or control activities which are subject to this section. Any merger, acquisition or control without that prior authorization shall be void and of no effect. No public utility organized and doing business under the laws of this state, and no subsidiary or affiliate of, or corporation holding a controlling interest in a public utility, shall aid or abet any violation of this section.

The decision stated that 1) the Sebastian Family has a track record of financing and providing quality telecommunications services in a California rural community; 2) Foresthill will continue to operate as it has in the past using the same name and operating authority and all rights and obligations of Foresthill shall remain after the transaction is completed; 3) approval of the transfer of control will not result in any changes to Foresthill's rates, tariffs, or manner in which service is provided; 4) the public may benefit from the transfer of control to the extent the transaction enhances Foresthill's ability to maintain and expand its services and operations in California, including broadband and vertical services; and 5) there is no opposition to the application.

In A.05-03-008, Foresthill mentioned an RUS financing contingency, whereby SEI would obtain financing from the RUS in an amount no less than $10,000,000, on terms reasonably satisfactory to SEI, to help finance SEI's acquisition of the stock. At some point, SEI formed a subsidiary named Fortel, a California corporation, and used Fortel to purchase the stock of Foresthill.

According to Foresthill, SEI made an equity contribution of $4 million for the acquisition of Hoeper's stock. Fortel and SEI also obtained a line of credit in the amount of $10,500,000 with Bank of America (BofA) to complete the stock acquisition transaction. The BofA line of credit is secured by the assets of the borrowers and carries an interest rate of prime minus 0.50 percentage points and had an initial term of 150 days, which was extended for up to 12 months when the loan commitment from the RUS was issued.[2] According to the loan documents, the borrowers' assets became security for the BofA loan. Currently, the term for the BofA line of credit will end on July 31, 2006.

As a result of the initial stock purchase, Fortel became the owner of all the outstanding shares of Foresthill. On August 25, 2005, SEI merged Foresthill with Fortel.[3] Each outstanding share of Fortel was converted to one (1) share of Foresthill. As part of the merger, Foresthill assumed all the liabilities of Fortel. Fortel then ceased to exist and Foresthill became a wholly owned subsidiary of SEI. Thus Foresthill assumed co-liability for the BofA debt used to acquire it and attempted to pledge its assets as security for the loan.

In compliance with Ordering Paragraph Number 3 of D.05-05-045, Foresthill, by letter, dated August 26, 2005, to the Commission, declared that the control and ownership of Foresthill was legally transferred to SEI, as of August 25, 2005. This letter did not mention the merger of Fortel into Foresthill, nor did it mention any encumbrance of Foresthill's assets or any liability assumed by Foresthill as a result of the merger.

b. Request for Financing

In the current Application, A.05-10-026, filed on October 21, 2005, Foresthill proposes to issue notes, in an amount not exceeding $24,901,250,

[2] The bank prime rate is 8%, as of the June 1, 2006 Federal Reserve Statistical Release daily update.

[3] On August 25, 2005, Fortel filed a Certificate of Ownership Merging Fortel, Inc. into Foresthill Telephone Company with the Office of the Secretary of State of the State of California, attached as part of Exhibit A to A.05-10-026.

and to execute related agreement and security instruments. Foresthill proposes to use this money to refinance the BofA interim loan and to fund further construction and system upgrades.

According to Foresthill, the promissory notes shall bear an interest rate to be determined in accordance with Section 305(d)(2)(A) of the Rural Electrification Act of 1936, as amended (7 U.S.C. 935 (d)(2)(A)) and the implementing regulations, as amended from time to time (7 C.F.R. 1735.31(c)), which is essentially the RUS' and the Bank's cost of money and will be repaid in amortizing monthly installment payments commencing two (2) years after execution and concluding sixteen (16) years after execution. The applicable rate of interest for advances under the RUS and the Bank loans are determined on the date of each advance and is essentially equal to the U.S. Government's cost of funds.[4] The rates so determined are generally and consistently much lower than rates available from private and commercial lenders. The notes will be secured by a security interest in Foresthill's facilities and assets.

On December 27, 2005, Foresthill filed a supplement to A.05-10-026, to address compliance with the California Environmental Quality Act (CEQA). Foresthill contends that CEQA review is not necessary at this time in order to approve the loan requested under A.05-10-026. Foresthill does not have any details regarding its contemplated projects, but does provide a general plan for the use of the loan proceeds: 1) replacement of an existing switch with a modern soft switch; 2) consolidation of existing digital loop carrier sites; 3) construction of facilities in a new subdivision; 4) construction of a fiber route in existing rights-of-way; and 5) for future projects to meet increasing demands for telecommunications services.

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[4] Currently, about 5% rate of interest.

The supplement indicates that Foresthill will comply with any environmental requirements to the extent applicable for future projects.

On February 17, 2006, Foresthill filed a second supplement to A.05-10-026, stating that the company is intending to book the interest expense associated with the refinancing of the $10.5 million of interim financing related to the transfer of control of Foresthill "below the line," in a non-regulated interest expense account, to ensure that there will be no impact on ratemaking related to the debt interest expense.[5]

On May 17, 2006, Foresthill submitted copies of the BofA Loan Agreement, Security Agreement, and Pledge Agreement executed by SEI and Fortel in connection with the $10.5 million interim financing used to complete the stock acquisition.

c. Financial Statements

Foresthill's income statement for the fiscal year ended December 31, 2004, shown as part of Exhibit B to the Application, presents total operating revenues of $3,730,213 and net income of $277,347. The balance sheet presented by Foresthill, as of December 31, 2004, is summarized as follows:[6]

Assets	Amount
Current Assets	$ 7,244,944
Investments	9,684
Net Telecommunications Plant	4,652,493
Total Assets	$11,907,121

Liabilities & Stockholders Equity

[5] Below-the-line items generally are not included in the determination of a utility's revenue requirement. In this instance, the interest expense related to the $10.5 million refinancing, would be charged to the utility's shareholders. Foresthill's second supplement does not resolve the issue of whether payments of principal are to be made by shareholders or ratepayers.

[6] Amounts shown are before the acquisition and merger.

Current Liabilities	$ 2,005,305
Deferred Credits	10,455
Stockholders' Equity	9,891,361
Total Liabilities & Stockholders Equity	$11,907,121

Foresthill's unaudited income statement for the fiscal year ended December 31, 2005, shown as an attachment to the electronic letter provided to staff on March 31, 2006, presents total operating revenues of $2,465,237 and a net loss of $266,449.[7] The balance sheet provided by Foresthill, as of December 31, 2005, is summarized as follows:[8]

Assets	Amount
Current Assets	$ 5,267,429
Investments	3,377,836
Net Telecommunications Plant	5,282,316
Total Assets	$13,927,581
Liabilities & Stockholders Equity	
Current Liabilities	$ 729,317
Long-term Debt	408,319
Deferred Credits	(5,957)
Stockholders' Equity	12,795,902
Total Liabilities & Stockholders Equity	$13,927,581

3. Notice and Protests

Notice of the filing of the Application appeared on the Commission's Daily Calendar of October 26, 2005. No protests have been received.

4. Discussion

There are two basic components of the proposed loan. One component of approximately $14,401,250, Foresthill requests be used to finance upcoming construction projects.[9] The other, of approximately $10,500,000, Foresthill

[7] Foresthill states its gross operating revenue went down by $1.2 million in 2005 due to a write-off of $700,000 associated with uncollectible Carrier Access Bills and a write-off of $550,000 for full depreciation of plant and other factors pursuant to interstate settlements.

[8] Amounts shown are after the acquisition and merger. The financial results are unaudited and not final. Tax accruals have not been finalized. This balance sheet does not reflect any liability of Foresthill for the Acquisition Debt. Foresthill states that it received advice from its financial advisor that it should show the Acquisition Debt as a liability only on the balance sheet of SEI, and merely show it as a footnote on Foresthill's balance sheet.

[9] Includes the purchase of Bank shares of approximately $488,250.

requests be used to refinance the debt incurred to purchase Hoeper's stock (the Acquisition Debt). We will address each of these components separately.

a. Financing for Capital Improvements

Foresthill states that it is faced with additional demand for telephone service and for system improvements. Foresthill claims that it is economically efficient to avail itself of lower cost government-subsidized financing for its projected construction program for years 2006 through 2009.

Construction Budget

Foresthill's 4-year construction budget, shown as part of Exhibit C to the Application, follows:

	2006	2007	2008	2009	Total
Land	$ 0	$ 0	$ 0	$ 0	$ 0
Street Improvements	0	0	0	0	0
Distribution Improvements	4,190,000	380,000	150,000	650,000	5,370,000
Miscellaneous	0	0	0	0	0
Contingencies	0	0	0	0	0
New Business	0	0	0	0	0
Office Equipment	30,000	35,000	15,000	10,000	90,000
Transportation Equipment	105,000	190,000	55,000	95,000	445,000
Other Equipment	875,000	3,170,000	1,305,000	3,146,000	8,496,000
Total	$5,200,000	$3,775,000	$1,525,000	$3,901,000	$14,401,000

Foresthill's forecasted construction budget for 2006 through 2009 totals $14,401,000. Currently, Foresthill has a pending general rate case proceeding via an advice letter filing (Advice Letter 263 filed on March 1, 2006). Therefore, the $14,401,000 construction budget or a portion thereof for years 2006 and 2007 is currently being reviewed by the Telecommunications Division. Accordingly, we will not make a finding in this Decision on the reasonableness of Foresthill's proposed construction program. Construction expenditures and the resulting plant balances in rate base are issues that are normally addressed in general rate cases.

Foresthill's 4-year cash requirements forecast, shown as part of Exhibit C to the Application, shows total funds needed for construction of $14,401,000. Foresthill proposes that this amount be financed entirely by the RUS and the Bank.

Construction Loan Approval

Article 5 of Chapter 4 of the Public Utilities Act (which is Part 1 of Division 1 of the Code) sets forth conditions a public utility must satisfy to issue debt. One condition is that the debt be for a permitted purpose listed in § 817. That Section states, in relevant part, as follows:

> Section 817: A public utility may issue stocks and stock certificates or other evidence of interest or ownership, and bonds, notes, and other evidences of indebtedness payable at periods of more than 12 months after the date thereof, for any one or more of the following purposes and no others:
>
> (b) For the construction, completion, extension, or improvement of its facilities.

Thus, the proposed construction loan is for a proper purpose under § 817.

Because long-term borrowings under the RUS and the Bank generally represent a much lower interest rate than other forms of debt, it is to the utility's advantage and that of its customers to avail itself of such funds. The RUS monitors the construction work and advances funds to a utility as portions of the work are completed. We should authorize the financing of capital improvements with the following conditions, so that loan proceeds, and the purposes for which they are expended, may be ascertained:

1. Foresthill shall deposit all loan advances in a bank or depository acceptable to the RUS and the Bank. Moneys in this account

shall be used solely for the construction purposes approved by the RUS or the Bank.

2. Foresthill shall maintain, at its premises, such books, documents, papers, or other records and supporting documents, including, but not limited to, invoices, and receipts, adequate to identify the purposes for which, and the manner in which the loan proceeds were expended on its construction projects.

3. On or before the 25th day of each month, Foresthill shall file with the Commission's Utility Audit, Finance and Compliance Branch (UAFCB) the reports required by General Order 24-B showing receipts and disbursements of the loan proceeds.

b. Acquisition Debt and its Refinancing

While D.05-05-045 provided that SEI may use a subsidiary to complete the stock transaction, if needed, it did not authorize SEI or its subsidiary to merge with Foresthill. As a result of the unapproved merger, Foresthill assumed responsibility for the liabilities of Fortel, principally the $10.5 million of interim financing Fortel and SEI incurred to complete the acquisition. In the process, the assets of Foresthill apparently were also pledged without permission from the Commission. Section 823(b) does state that:

> A public utility may issue notes, for proper purposes and not in violation of any provision of law, payable at periods of not more than 12 months after the date of issuance of the notes without the consent of the commission.

Under this provision, a utility may issue an *un*secured promissory note payable on or before twelve months after date of issue without securing the consent of the Commission, but because of § 851, it may not execute a mortgage or other encumbrance upon its properties used in its public utility operations without first being authorized by the Commission.

Section 851 states in part:

> No public utility…shall sell, lease, assign, mortgage or otherwise dispose of or encumber the whole or any part of its…plant, system, or other property necessary or useful in the performance of its duties to the public, or any franchise or permit or any right thereunder, . . . without first having secured from the commission an order authorizing it so to do. Every such . . . encumbrance . . . made other than in accordance with the order of the commission authorizing it is void.

Based on our review of the interim (BofA) loan documentation, it appears that Foresthill, by merging Fortel into itself, has attempted to encumber its operating assets to secure the interim loan and has attempted to make Foresthill liable for the principal and interest payments on that BofA loan. Thus, it appears that Foresthill has already purported to encumber its system with this Acquisition Debt. However, prior to this Decision, the Commission has never approved either the encumbrance of Foresthill's system, nor the merger.

Foresthill has stated that the RUS requires that Foresthill book any loan amounts from the RUS, including the $10.5 million refinancing of the Acquisition Debt, on Foresthill's books. Foresthill is also required by the RUS to issue a security interest for any amounts loaned to it.

Many loan transactions, including the one that is the subject of this Application, are negotiated to conform to the borrower's and lender's requirements. The funding process is a lengthy one and, in this instance, the RUS and the Bank have specifically indicated in the proposed loan agreement, that the first advance of funds shall be limited to refinancing the Acquisition Debt. The RUS and the Bank state that no further advances will be made until any debts incurred through interim financing and all associated liens have been discharged.

In other words, the Acquisition Debt will need to be refinanced before any of the construction funds are released, and thus there will not be any lender with a higher priority than the RUS or the Bank. In addition, Article IV (2) (C) of Schedule 1 of the Loan Agreement, attached to the Second Supplement to the Application, requires Foresthill to provide the RUS and the Bank evidence of the approval of the merger of Fortel and Foresthill by the appropriate state regulatory bodies. It is in this manner that the RUS and the Bank have committed to provide Foresthill with the loan.

Foresthill has arranged to get low-cost financing from the RUS and the Bank for its construction program, but this financing is dependent on the re-financing of the Acquisition Debt and the Acquisition Debt being a liability of Foresthill. Thus, we have to balance the desirability of approving a construction loan from the RUS and the Bank with the disadvantages of having the refinancing of the Acquisition Debt be a liability of Foresthill, the regulated utility. Foresthill's assumption of the Acquisition Debt is potentially problematic, because (i) ratepayers are at risk of having to pay off the loan and (ii) there is a risk that the operating assets of Foresthill could be foreclosed upon in the event of non-payment, which could also adversely affect Foresthill's customers.

We conclude that the benefit to Foresthill and its customers of infusing low cost capital and the eventual service enhancement to its subscribers, outweigh the disadvantages of having Foresthill being liable for the Acquisition Debt, particularly as we can ameliorate some of those disadvantages by placing conditions on the financing authority. In particular, our conditions will prevent any ratepayer liability for retiring the debt.

Furthermore, because the RUS and the Bank are federal agencies whose job is to promote rural telephone service, it seems entirely unlikely that they will dismantle the company in order to pay off the debt nor does it seem likely that they would find an unfit buyer if the company should need to be sold in order to pay off the debt.

It is to this end, that the authority we are granting in this Decision is premised, in order to enable Foresthill, a utility under our jurisdiction, to comply with the requirements set forth by the federal agency responsible for financial assistance, thereby enabling ratepayers to benefit from a lower interest rate to finance needed improvements.

Merger and Refinancing Approval

Because the RUS and the Bank conditioned the release of the construction funds upon the completion of the refinancing of the Acquisition Debt, we will accommodate the transaction, by prescribing terms and conditions on the refinancing of the Acquisition Debt that will protect ratepayers. These conditions are discussed further below.

We also need to deal with several additional legal issues. First, pursuant to §§ 817, 818, and 823(a), (d), the proceeds of Commission-authorized debt may only be used for certain purposes.[10] One of these is "for the reorganization or readjustment of its indebtedness or capitalization upon a merger, consolidation, or other reorganization" (§ 817(f)). Based on the specific facts present here, we conclude that the Acquisition Debt was incurred in connection with a reorganization and that the Commission can therefore approve its refinancing as a debt of the utility.

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[10] The refinancing of utility notes payable at a period of not more than 12 months is governed by Section 823(d) that states: No note payable at a period of not more than 12 months after the date of issuance of such note shall, in whole or in part, be refunded by any issue of stocks or stock certificates or other evidence of interest or ownership, or of bonds, notes of any term or character, or any other evidence of indebtedness, without the consent of the commission.

Additional conditions on the construction financing required by the RUS and the Bank are that the Acquisition Debt must be a liability of Foresthill and that the merger of Fortel into Foresthill has any necessary state regulatory approvals. Accordingly, we will approve the merger of Fortel into Foresthill, but only on a going-forward basis. Thus, nothing in this Decision will change the status of the merger of Fortel into Foresthill at any prior date (i.e., whether the merger was then legal or not). Similarly, nothing in this Decision should be construed as granting any authority to Foresthill to encumber its assets to secure the BofA loan.

In order to provide safeguards for Foresthill's ratepayers in connection with the liability for the refinancing of the Acquisition Debt, we will require Foresthill to submit prior to entering into the loan agreement with the RUS and the Bank, a declaration signed by duly authorized officers of Foresthill and SEI, under penalty of perjury under the laws of the State of California, stating that for rate making purposes, the utility shall:

> (a) book "below the line," both principal and interest expense of the refinancing of the Acquisition Debt, which shall be the responsibility of the shareholders to pay;
>
> (b) state that the refinancing of the Acquisition Debt shall have no impact on Foresthill's current and future revenue requirement; and
>
> (c) state that the refinancing of the Acquisition Debt and/or revenue requirement associated with the refinancing shall not be included in any current or future calculations for determination of the California High Cost Fund-A (CHCF-A) draws for Foresthill.

To the extent that the RUS and the Bank have given their commitments to provide funding to Foresthill, which is under our jurisdiction, we will give the regulated utility the opportunity, subject to conditions, to avail itself of this borrowing with rates generally and consistently much lower than rates available from private and commercial lenders.

With conditions in place for both the funding of the construction programs and the refinancing of the Acquisition Debt, Foresthill should be granted authority in this proceeding, to enter into a loan agreement with the RUS and the Bank, in an amount not to exceed $24,901,250. The allocation or distribution of the $24,901,250 loan among the RUS and the Bank should be determined by Foresthill, the RUS and the Bank.

Capital Structure

Foresthill's capital structure, shown as part of Exhibit C to the Application (revised), is shown below, as recorded, and as adjusted, giving pro forma effect to the $24,901,250 loan, which includes the refinancing of the $10.5 million Acquisition Debt:

	Recorded (As of 12/31/05)		Adjustments	Proforma	
Long-term debt	$ 0	0.0%	$24,901,250	$24,901,250	84.7%
Short-term debt	11,000,000[11]	73.3%	(10,500,000)	500,000	1.7%
Subtotal	$11,000,000	73.3%	$14,401,250	$25,401,250	86.4%
Preferred Stock	0	0.0%	0	0	0.0%
Common Equity	4,000,000	26.7%	0	$ 4,000,000	13.6%
Total Capitalization	$15,000,000	100.0%	$14,401,250	$29,401,250	100.0%

While the new financing will have a material effect on Foresthill's actual capital structure, capital structures are normally subject to review in cost of capital or general rate case proceedings. At such time, a particular rate of return will be determined. A debt to equity ratio, which may be different

[11] Includes the $10.5 million Acquisition Debt.

from that resulting from the debt transaction authorized in this Decision, may be imputed, in order to properly compute the cost of capital.

We place Foresthill on notice that the Commission does not encourage a highly leveraged capital structure.[12] Our decision regarding the refinancing of the Acquisition Debt is simply permissive and based solely on the facts of this particular case. The authority to refinance the Acquisition Debt should not be construed to constitute an implied or expressed indemnification by ratepayers in the event Foresthill is unable to meet its obligations under this part of the financing transaction nor is it to be taken as establishing a policy to be followed in other financing proceedings.

5. Prior Compliance with Section 851

Pursuant to § 851, we will allow Foresthill to encumber its property on a going forward basis to secure the debt authorized herein.

While we approve the requested financing in this proceeding, we have concerns regarding compliance with § 851 in connection with the BofA interim financing of the Acquisition Debt. Review of such compliance is outside the scope of this present application for approval of the issuance of notes to the RUS and the Bank. Therefore, the Commission will open a separate investigation into the circumstances surrounding the BofA loan to determine if Foresthill violated the Code or Commission orders and, if so, whether penalties should be imposed. We will also address whether Foresthill has accounted for any payments made on this interim debt consistent with the below-the-line requirements imposed in this Decision.

6. Environmental Impact

[12] The higher the proportion of debt to equity capital, the larger the fixed charges of interest and debt repayment, and the greater the likelihood of insolvency during protracted periods of earnings decline or other adversities.

The California Environmental Quality Act (Public Resources Code Section 21000, et seq., hereafter "CEQA") applies to discretionary projects to be carried out or approved by public agencies. A basic purpose of CEQA is to inform governmental decision-makers and the public about the potential, significant environmental effects of proposed activities. (CEQA Guideline Section 15002).

Where CEQA applies, a public agency must act either as a Lead Agency or a Responsible Agency. Generally, the Lead Agency is the public agency with the greatest responsibility for supervising or approving the project as a whole. (CEQA Guideline Section 15051(b).) CEQA requires that a Responsible Agency consider the Lead Agency's Environmental Impact Report, Negative Declaration or Mitigated Negative Declaration prior to acting upon or approving a project. (CEQA Guideline Section 15050(b).) The specific activities that must be conducted by a Responsible Agency are contained in CEQA Guideline Section 15096.

According to Foresthill, the requested authority to enter into a loan agreement and to execute the loan documents does not have any significant adverse effect on the environment. Foresthill is an incumbent local exchange carrier with a statutorily granted facilities-based provider authority.

In acting on §§ 818 and 851 applications, the Commission is making a discretionary decision and, where CEQA applies, must act as either a Lead or Responsible Agency under CEQA. In its Application, Foresthill specifies that the purpose of the Application is to secure approval for a loan (from the RUS and the Bank) to be used for prospective plant improvements. Based on the facts, here, CEQA does not apply because the decision to approve Foresthill's Application does not constitute an order approving a project within the scope of CEQA. Here, Foresthill has not asked for approval of any specific projects, nor is this financing Order authorizing any specific capital expenditures or construction projects.

Here, we approve the construction loan, as discussed in this Order above, so that Foresthill is in a better position to undertake plant improvements (i.e., because it will have already secured financing and will have no further delays relating to financing) once it has finalized its plant improvement plans. Our approval of the financing here, however, does not excuse Foresthill from obtaining any necessary environmental approvals for the specific projects it decides to undertake before it goes ahead with any work.[13]

Although we approve Foresthill's debt financing Application pursuant to § 818 and § 851, we place Foresthill on notice that the approval of the construction loan request does not constitute an implied or expressed waiver of applicable environmental regulations. As it states in its Application, Foresthill will comply with all environmental permitting or other environmental requirements applicable to the projects that it will undertake in conjunction with the proposed debt issue. This includes undergoing any environmental review required under CEQA, and complying with any environmental regulations the Commission may adopt in R.00-02-003.[14]

Foresthill will not use the proceeds authorized by this Order to begin construction of capital projects until Foresthill has obtained all required approvals from this Commission, and any other agencies who so require, including any environmental approvals, if applicable.

7. Fees

[13] Moreover, Foresthill has indicated that it does not know at this time which projects it will undertake, or the specific details of potential projects it may undertake, associated with the authority to issue debt here. Accordingly, it would be premature at this time to conduct any environmental review.

[14] In this rulemaking, the Commission is reviewing how it will apply CEQA to telecommunications utilities under the Commission's jurisdiction.

Whenever the Commission authorizes a utility to issue debt, the Commission is required to charge and collect a fee in accordance with § 1904(b) and § 1904.1.

Pursuant to § 1904(b), Foresthill should pay the fee of $18,451.[15]

8. Categorization and Need for Hearings

In Resolution (Res.) ALJ 176-3161 dated October 27, 2005, the Commission preliminarily categorized this Application as ratesetting, and preliminarily determined that hearings were not necessary. No protests have been received, and a public hearing is not necessary to address the issues resolved in this decision. Given these developments, there is no need to alter the preliminary determinations made in Res. ALJ 176-3161.

9. Assignment of Proceeding

Kevin P. Coughlan is the assigned Examiner in this proceeding.

10. Comments

The draft decision of Examiner Coughlan was mailed to the parties in this matter in accordance with 311(g)2 and Rule 77.7 of the Rules of Practice and Procedure. Pursuant to Rule 77.7(g), Foresthill and the Division of Ratepayer Advocates have stipulated that comments will be filed no later than June 26, 2006 and that there will be no reply comments. Comments were filed on (date).

Findings of Fact

1. Foresthill, a California corporation, is a public utility subject to the jurisdiction of this Commission.

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[15] The amount subject to the fee is $24,901,250. The fee is determined as follows: ($2 x (1,000,000/1,000)) + ($1 x (9,000,000/1,000)) + ($0.50 x (14,901,250/1,000)) = $18,451.

2. Foresthill needs external funds to improve and expand its system, as set forth in the Application. Foresthill estimates it needs approximately $14,401,000.

3. Debt issued for construction, completion, extension, or improvement of facilities is for proper purposes and is not adverse to the public interest.

4. The Telecommunications Division is currently processing Foresthill's general rate case filing.

5. The Commission does not by this decision determine that the construction budget, cash requirements forecast, and capital ratios presented herein are necessary or reasonable for purposes of setting rates.

6. An Acquisition Debt of $10,500,000 was incurred in connection with SEI's acquisition of Foresthill.

7. The RUS and the Bank require that the Acquisition Debt be a liability of Foresthill.

8. The financial assistance provided by the RUS and the Bank allows acquisition of an estimated $24,901,250 at below market rates.

9. Authorizing Foresthill in this proceeding to encumber utility assets on a going forward basis, as required to secure the RUS and the Bank loans, is not adverse to the public interest.

10. Because of the conditions that the RUS and the Bank have placed on their loans, it is necessary to approve the merger of Fortel into Foresthill on a prospective basis.

11. Foresthill did not obtain any authorization from the Commission to pledge its assets to secure the BofA interim loan.

12. Authorizing the refinancing of the Acquisition Debt requires conditions to protect the ratepayers, principally that the refinancing of the Acquisition Debt be booked below the line.

13. Notice of the filing of the Application appeared on the Commission's Daily Calendar of October 26, 2005. There is no known opposition to this Application, and the authority requested should be granted, as conditioned herein.

Conclusions of Law

1. A public hearing is not necessary for the authorization granted herein.

2. The merger of Fortel into Foresthill should be approved on a going-forward only basis, to facilitate the proposed below-market-rate financing.

3. The status of the merger of Fortel into Foresthill prior to this Decision remains the same and unaltered.

4. Because the RUS and the Bank borrowings represent a much lower cost of capital than either equity or other forms of debt, it is to Foresthill's advantage to avail itself of such funds for its financing requirements.

5. Approval of this financing application is not subject to CEQA.

6. It is Foresthill's responsibility to abide by and comply with any applicable environmental regulations for any capital improvement undertaken with funds obtained under this debt authorization.

7. The refinancing of the $10.5 million interim debt used to acquire Foresthill is subject to § 823(d).

8. The shareholders of Foresthill, not its ratepayers, should be responsible for the payment of the principal and interest on the refinancing of the Acquisition Debt.

9. It is appropriate that the Commission open an investigation regarding compliance with § 851 in connection with the BofA interim financing and, if there is a violation, determine whether and what penalties should be imposed. The Commission should address whether Foresthill has

accounted for any payments made on this interim debt consistent with the below-the-line requirements imposed in this Decision.

10. Foresthill should pay the fee determined in accordance with § 1904(b).

11. The Application should be granted to the extent set forth in the order that follows.

12. The following order should be effective on the date of signature.

ORDER

IT IS ORDERED that:

1. After the effective date of this order, Foresthill Telephone Company (Foresthill), upon terms and conditions substantially consistent with those set forth or contemplated in Application (A.) 05-10-026 (Application), as supplemented, is authorized to enter into a Telephone Loan Contract with The United States of America, acting through the Rural Utilities Service (RUS) and the Rural Telephone Bank (Bank) for a total sum not exceeding $24,901,250 for purposes specified in the Application, subject to the conditions set forth herein.

2. Foresthill may execute and deliver a Loan Agreement and a Mortgage Security Agreement and Financing Statement on substantially the same terms and conditions as set forth in the draft loan documents under Tab 1 of the Second Supplement to Application.

3. Foresthill shall keep and maintain copies of the loan documents and promptly upon request provide copies to the Commission's Utility Audit, Finance and Compliance Branch (UAFCB).

4. This financing Order does not authorize any capital expenditures or construction projects. Foresthill shall not use the proceeds authorized by this Order to begin construction of capital projects until Foresthill has obtained the

required approvals from the Commission, if any, including complying with any applicable environmental regulations or complying with any regulations the Commission may adopt in R.00-02-003.

5. Prior to entering into the loan agreement with the RUS and the Bank, Foresthill shall submit to the Commission's UAFCB, a declaration signed by duly authorized officers of Foresthill and SEI, under penalty of perjury under the laws of the State of California, stating that for rate making purposes, the utility shall (a) book "below the line" both principal and interest expense of the refinancing of the Acquisition Debt, which shall be the responsibility of the shareholders to pay; (b) state that the acquisition loan shall have no impact on Foresthill's current and future revenue requirement; and (c) state that the refinancing of the Acquisition Debt and/or revenue requirement associated with the refinancing shall not be included in any current or future calculations for determination of the California High Cost Fund-A draws for Foresthill.

6. Within sixty days from the date of this order, Foresthill shall provide the Commission's UAFCB a copy of the release of mortgage from the Bank of America.

7. Foresthill shall deposit all construction loan advances from the RUS and the Bank in a bank or depository acceptable to the RUS and the Bank. Moneys in this account shall be used solely for the construction purposes approved by the RUS or the Bank.

8. Foresthill shall maintain, at its premises, such books, documents, papers, or other records and supporting documents, including, but not limited to, invoices and receipts, adequate to identify the purposes for which, and the manner in which the construction loan proceeds were expended on its construction project.

9. On or before the 25th day of each month, Foresthill shall file with the Commission's UAFCB the reports required by General Order Series 24.

10. A copy of this Decision shall be mailed to the following:

a) Rural Utilities Service
United States Department of Agriculture
1400 Independence Avenue, S.W.
Washington, D.C. 20250-1500
Attention: Administrator

b) Rural Utilities Service
United States Department of Agriculture
1400 Independence Avenue, S.W.
Stop 1597, Room No. 2808
Washington, D.C. 20250-1597
Attention: Ken B. Chandler

c) Baker, Manock & Jensen
Fig Garden Financial Center
5260 North Palm Avenue
Fourth floor
Fresno, CA 93704

11. The authority granted by this order shall become effective when Foresthill pays $18,451 as required by Public Utilities Code § 1904(b).

12. A.05-10-026 is closed.

This order is effective today.

Dated ____________________, at San Francisco, California.